

Memorandum of Decision: 04-20210122
Gross Retail and Use Tax
for the Years 2017 Through 2020

NOTICE: IC § 4-22-7-7 permits the publication of this document in the Indiana Register. The publication of this document provides the general public with information about the Indiana Department of Revenue's official position concerning a specific set of facts and issues. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Memorandum of Decision.

HOLDING

Manufacturer was entitled to a refund of use tax on transactions under which Manufacturer obtained software services, occurring prior to July 1, 2018, where Manufacturer did not acquire a possessory interest in the vendors' software. Manufacturer was entitled to a refund of use tax of transactions for services which did not involve tangible personal property. Manufacturer's refund claims are denied in all other respects.

ISSUES

I. Gross Retail and Use Tax - Prewritten Computer Software and Software as an Exempt Service.

Authority: IC§ 6-2.5-1-27; IC§ 6-2.5-2-1; IC§ 6-2.5-3-1; IC§ 6-2.5-3-2; IC§ 6-2.5-4-17; IC §§ 6-2.5-5 et seq.; IC § 6-2.5-13-1; *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2011); *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Mynsberge v. Department of State Revenue*, 716 N.E.2d 629 (Ind. Tax Ct. 1999); *State Bd. of Tax Comm'rs v. Jewell Grain Co.*, 556 N.E.2d 920 (Ind.1990); *Tri-States Double Cola Bottling Co. v. Department of State Revenue*, 706 N.E.2d 282 (Ind. Tax Ct. 1999); [45 IAC 2.2-3-14](#); [45 IAC 2.2-5-3](#); [45 IAC 2.2-5-6](#); [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-9](#); [45 IAC 2.2-5-10](#); Sales Tax Information Bulletin 8 (December 2016); Sales Tax Information Bulletin 8 (July 2018).

Taxpayer argues that it is entitled to a refund of Indiana use tax paid on transactions of the acquisition or use of prewritten computer software.

II. Gross Retail and Use Tax - Unverified Refund Claims.

Authority: IC§ 6-2.5-2-1; IC§ 6-2.5-3-2; IC§ 6-2.5-4-16.4; IC§ 6-2.5-5-3; IC§ 6-2.5-13-1; *Merch. Warehouse Co. v. Indiana Dep't of State Revenue*, 87 N.E.3d 12 (Ind. 2017); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629 (Ind. Tax Ct. 1999); *N Cent. Indus., Inc. v. Indiana Dep't of State Revenue*, 790 N.E.2d 198 (Ind. Tax Ct. 2003).

Taxpayer argues the transactions that were not verified by the Department's review of the refund claim were exempt transactions and should entitle it to a refund of Indiana use tax.

STATEMENT OF FACTS

Taxpayer is an Indiana-based company which submitted a claim for refund for approximately \$547,000 paid as use tax. Approximately \$211,000 of this claim involved transactions for prewritten computer software. The Indiana Department of Revenue ("Department") denied the refund relating to Software as a Service, stating that "SaaS [Software as a Service] are considered taxable," referring Taxpayer to Information Bulletin 8 for further details. The remaining claim was denied because the transactions in question could not be verified. Taxpayer disagreed with the denial and submitted a protest to that effect. An administrative hearing was held during which Taxpayer's representative explained the basis for the protest. This Memorandum of Decision results. Additional facts will be provided as necessary.

I. Gross Retail and Use Tax - Prewritten Computer Software and Software as an Exempt Service.

DISCUSSION

Taxpayer filed a claim for refund of sales and/or use tax paid in 2017 and 2018 on transactions involving software. The Department denied the claim and Taxpayer filed a protest of that denial. The issue is whether Taxpayer is

entitled to a refund of sales tax paid on software purchases executed prior to July 1, 2018.

A taxpayer is required to provide documentation explaining and supporting its challenge that the Department's position is wrong; poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n. 9 (Ind. Tax Ct. 2011). When an agency is charged with enforcing a statute, the jurisprudence defers to the agency's reasonable interpretation of that statute "over an equally reasonable interpretation by another party." *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014).

Indiana imposes an excise tax called the "state gross retail tax" or "sales tax" on retail transactions made in Indiana. IC§ 6-2.5-2-1(a). "When the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location." IC§ 6-2.5-13-1(d)(l). When a product is not received by the purchaser at a business location of the seller, the sale is sourced to the location where receipt by the purchaser occurs. IC § 6-2.5-13-1(d)(2).

Indiana also imposes a complementary excise tax called the "use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC§ 6-2.5-3-1(a).

IC§ 6-2.5-1-27 incorporates "prewritten computer software" in the definition of tangible personal property subject to sales/use tax:

"Tangible personal property" means personal property that:

- (1) can be seen, weighed, measured, felt, or touched; or
- (2) is in any other manner perceptible to the senses.

The term includes electricity, water, gas, steam, and prewritten computer software.

A person who acquires property in a retail transaction (a "retail purchaser") is liable for the tax on the transaction. IC§ 6-2.5-2-1(b). As to any of Taxpayer's vendor agreements to supply software maintenance or software updates, IC § 6-2.5-4-17 provides:

A person is a retail merchant making a retail transaction when the person enters into a computer software maintenance contract to provide future updates or upgrades to computer software.

As a general rule, all purchases of tangible personal property - including prewritten computer software - are subject to sales or use tax unless specifically exempted by statutes or regulations. [45 IAC 2.2-5-3\(b\)](#); [45 IAC 2.2-5-6\(a\)](#); [45 IAC 2.2-5-8\(a\)](#); [45 IAC 2.2-5-9\(a\)](#); [45 IAC 2.2-5-10\(a\)](#). Various sales tax exemptions are outlined in IC§§ 6-2.5-5 et seq. which are also applicable to use tax. [45 IAC 2.2-3-14\(2\)](#).

In considering Taxpayer's argument that the purchase of software services is not subject to sales tax, the Department bears in mind that IC§ 6-2.5-2-1 is a tax imposition statute and is strictly construed against the imposition of tax. *Mynsberge v. Department of State Revenue*, 716 N.E.2d 629, 633 (Ind. Tax Ct. 1999); see also *State Bd. of Tax Comm'rs v. Jewell Grain Co.*, 556 N.E.2d 920, 921 (Ind. 1990) and *Tri-States Double Cola Bottling Co. v. Department of State Revenue*, 706 N.E.2d 282, 285 n. 9 (Ind. Tax Ct. 1999).

Taxpayer protested the refund denials concerning the following vendors and provided documentation to support its argument. In certain instances, Taxpayer provided copies of the underlying contract, written agreement, invoices, or terms of use.

CDW Corporation

Taxpayer purchased security and information mapping software from CDW. Taxpayer provided invoices confirming the transactions and related terms and conditions.

According to its agreement with CDW, Taxpayer has a non-exclusive, non-transferrable right to access the software for a designated amount of time. Upon termination of the agreement, or per request by the Taxpayer, CDW will return or delete the Taxpayer's personal data provided as part of the software use. Termination of the agreement also ends Taxpayer's access to the software, which must be returned.

Kronos Inc.

Taxpayer purchased workforce management and data collection software from Kronos. Along with publicly available information, Taxpayer provided invoices confirming the transactions and related terms and conditions.

The agreement with Kronos grants Taxpayer a limited, revocable, non-transferrable right to access the software during a specific term. Kronos retains ownership of all rights, titles, and interests beyond this. Taxpayer is prohibited from copying the software or using it in a manner not enumerated in the contract. The customer can request additional features or services, but these would be provided as a separately billed and delivered item.

Microsoft

Taxpayer purchased data analysis, web application management, customer relationship management, and business productivity software from Microsoft. Along with publicly available information, Taxpayer provided invoices and terms of service for the agreement between itself and Microsoft.

According to the agreement with Microsoft, Taxpayer purchased a fixed-term license for access to the Microsoft software. Taxpayer may download, install, and use certain products on its own computers, but others must be used only through online access to Microsoft's servers. Taxpayer cannot lease, transfer, reverse engineer, or host for third parties any software or portion of the software. Microsoft retains the right to update or modify the software. The term of this agreement, and Taxpayer's ability to renew the agreement, are specifically stated. If the agreement is terminated, Taxpayer must destroy the software and discontinue use.

Redwood Software

Taxpayer purchased workload automation software from Redwood Software. Taxpayer provided invoices confirming the transactions and the related agreements.

Redwood Software granted Taxpayer a non-exclusive, non-transferrable limited right to use the software. Taxpayer was forbidden from reverse engineering, disassembling, copying, modifying, or altering the software. Redwood Software retains all rights, title, and interest in the software. Once the right to use the software terminates, Taxpayer is no longer able to access the software and Redwood Software no longer retains Taxpayer's data.

ServiceNow

Taxpayer purchased technical management support software from ServiceNow. Along with publicly available information, Taxpayer provided invoices and related terms and conditions.

Taxpayer pays ServiceNow for a limited license to access software. ServiceNow explicitly retains rights, title, and interest to the software and related intellectual property. Taxpayer is prohibited from disassembling, copying, reverse engineering, or deriving other works from ServiceNow's software. Once the agreement is terminated, Taxpayer no longer has access to the software.

Workday Inc.

Taxpayer purchased enterprise resource planning from Workday Inc. Along with publicly available information, Taxpayer provided invoices and related subscription agreements.

Taxpayer pays Workday for access to its software. Taxpayer retains rights in all of the data it uses with the Workday software and is prohibited from modifying the Workday software. Workday reserved the right to suspend or terminate access to the software at any time.

Sales Tax Information Bulletin 8 (July 1, 2018), 20180725 Ind. Reg. 045180312NRA, explains how to analyze software transactions which occurred prior to July 1, 2018:

[T]ransactions involving remotely accessed software occurring prior to July 1, 2018, will need to be analyzed using guidance published in the prior version of this bulletin.

As such, the vendor transactions which occurred during and after December 2016 are governed by Sales Tax Information Bulletin 8 (December 2016), 20170125 Ind. Reg. 045170026NRA. Information Bulletin 8 provides guidelines for distinguishing transactions in which a customer purchases taxable, prewritten software from those

in which the customer is paying for access to and use of software that the customer does not own. As explained in Sales Tax Information Bulletin 8 (December 2016):

Charges for accessing prewritten software maintained on [a] vendor or third party's computer servers are not subject to tax when accessed electronically via the Internet if the customer is not transferred the software, does not have an ownership interest in the software, and does not control or possess the software on the server.

In deciding whether the buyer has acquired "an ownership interest" in the software, the 2016 Bulletin further provides:

In order to determine whether a purchaser obtains a possessory or ownership interest in prewritten software, the following factors that indicate a possessory or ownership interest should be considered:

- Whether the Indiana customer obtains or is granted the right to access or download copies of the software to the customer's own computers, servers, or network;
- Whether the Indiana customer gains or is granted the right to modify or customize the pre-written software;
- Whether the Indiana customer gains or is granted the right to make copies of the pre-written software for the customer's own use;
- Whether the Indiana customer is required to pay additional amounts for enhancements, modifications, or updates to the software;
- Whether the provider has a policy of providing a duplicate copy of the software at minimal or no charge if the customer loses or damages the software;
- Whether the Indiana customer gains or obtains the right to use, deploy, or access the software for an unlimited or indeterminate period of time;
- Whether the software must be returned or destroyed at the end of a specifically limited license period;
- The relative price paid for accessing or using the software compared to the price charged for obtaining a possessory or ownership interest in that same, similar, or comparable software.

Based on the documentation provided, the Department agrees that these transactions were not subject to Indiana's sales and use tax because the transactions called for the provision of software services and granted Taxpayer no possessory interest in the underlying prewritten software during or after the subscription term. The Department will refund use tax to the extent Taxpayer's payment of use tax can be verified.

FINDING

Taxpayer's protest is sustained, subject to verification of use tax remittance.

II. Gross Retail and Use Tax - Unverified Refund Claim.

DISCUSSION

Taxpayer argues that several transactions between 2017 and 2020, which the Department could not verify during its review of the refund claim, should qualify as exempt from Indiana sales and use tax. These transactions involve a variety of different claims, but generally fall into two categories: statutory exemptions from tax and exclusions from tax imposition statutes. Tax imposition statutes are strictly construed against the imposition of tax, while tax exemptions are strictly construed in favor of imposing tax. *Compare Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629, 633 (Ind. Tax Ct. 1999) with *N Cent. Indus., Inc. v. Indiana Dep't of State Revenue*, 790 N.E.2d 198, 200 (Ind. Tax Ct. 2003). These standards will be considered as they relate to each of the refund claims, while also ensuring that the Taxpayer provided sufficient documentation to show that the Department's position is wrong.

Non-Taxable Services

Taxpayer states that transactions with Secureworks, Microsoft, and Gartner are for the provision of services instead of for tangible goods and are therefore excluded from the sales and use tax imposition statutes. To support this argument, Taxpayer provided invoices for each of the claimed transactions.

Secureworks provided endpoint monitoring services and computer security to Taxpayer. The related invoices clearly state when the purchase in question is for monitoring or other services. These services are not tangible personal property and are not subject to sales and use tax. However, these invoices also include transactions for

consoles, appliances, network interface modules, devices, scanner rentals, and standalone software. These items are tangible personal property and are taxable in Indiana.

Gartner is a research and consulting firm that provided consulting services to Taxpayer. Based on the invoices provided in this case, only consulting fees for Gartner's Industry Advisory Services were part of Taxpayer's refund request. These transactions for services are not subject to sales and use tax.

Microsoft's contract with Taxpayer contemplates additional expenses for software. These services are not subject to sales and use tax as no tangible personal property or possessory interest in software changed hands.

Transactions Occurring Outside of Indiana

Taxpayer states that transactions with SAP America did not occur in Indiana and therefore are not subject to sales and use tax in Indiana. Sales tax is imposed on retail transactions occurring in Indiana. IC § 6-2.5-2-1. IC § 6-2.5-13-1 explains how to determine where a transaction occurs. Use tax is imposed on the storage, use, or consumption of tangible personal property in Indiana, regardless of the location of the transaction. IC § 6-2.5-3-2.

Taxpayer provided invoices from SAP America Inc. documenting the purchases in question. These invoices include a "Ship-to-Party" address in either Canada or Indiana. This would indicate that the sale of these transactions should be sourced to one of these two locations for taxation purposes. However, Taxpayer is claiming a refund of use tax, which is imposed regardless of the location of the transaction. Taxpayer provided no evidence regarding the storage, use, or consumption of the property. Therefore, Taxpayer did not demonstrate that it is due a use tax refund for these transactions.

Temporary Storage

Taxpayer states that a portion of its transactions with Microsoft were not subject to use tax as they were only temporarily stored in Indiana. To support this argument, Taxpayer provided invoices for each of the claimed transactions.

IC § 6-2.5-3-2 explains when use tax is not imposed on tangible personal property due to it only being temporarily stored in Indiana:

(e) Notwithstanding any other provision of this section, the use tax is not imposed on the keeping, retaining, or exercising of any right or power over tangible personal property, if:

- (1) the property is delivered into Indiana by or for the purchaser of the property;
- (2) *the property is delivered in Indiana/or the sole purpose of being processed, printed, fabricated, or manufactured into, attached to, or incorporated into other tangible personal property;* and
- (3) the property is subsequently transported out of state for use solely outside Indiana.

Taxpayer provided no evidence that these licenses were processed, printed, fabricated, or manufactured into, attached to, or incorporated into other tangible personal property. Therefore, these transactions are not excluded from Indiana use tax under IC § 6-2.5-3-2.

Direct Manufacturing

Taxpayer states that transactions with Lofware are for software used to affix barcodes to goods and are therefore exempt from tax. To support this argument, Taxpayer provided invoices for each of the claimed transactions. IC § 6-2.5-5-3 establishes an exemption from sales and use tax for equipment directly used in the direct production of tangible personal property.

The Indiana Supreme Court has explained that this process includes steps which are essential and integral to transforming tangible property into a distinct marketable good. *Merch. Warehouse Co. v. Indiana Dep't of State Revenue*, 87 N.E.3d 12, 21 (Ind. 2017). The Indiana Tax Court has further explained that simply sorting, labeling, and packaging goods is insufficient to qualify for this exemption. *N Cent. Indus., Inc. v. Indiana Dep't of State Revenue*, 790 N.E.2d 198,201 (Ind. Tax Ct. 2003).

Based on the invoices provided and the explanation of the use of the software in question, the Department finds that labeling an already-existing product with a bar code is insufficient to qualify for this exemption. Affixing a barcode may help with inventory management, but it is not essential and integral to changing an item into a distinct marketable good and so are not exempt under IC § 6-2.5-5-3.

Digital Products

Taxpayer claims that its transactions with Shutterstock are not subject to sales and use tax because they are purchases of digital images. To support this argument, Taxpayer did not provide invoices or other evidence for these transactions. Without evidence supporting its claim, Taxpayer has failed to demonstrate that it is entitled to a refund.

Even so, Taxpayer's argument is incorrect. IC§ 6-2.5-4-16.4 explains that the purchase of specified digital products is subject to sales and use tax. Contrary to Taxpayer's claim, the purchase of a specific digital image qualifies as the purchase of a specified digital product, much like the purchase of a photograph qualifies as the purchase of a tangible good. Taxpayer's claim is denied.

For the reasons discussed above, Taxpayer's claimed exceptions from tax for purchases outside of Indiana, temporary storage, and digital products are denied. Taxpayer's exception claimed for the purchase of services is granted, except to the extent that the provided Secureworks invoices show the purchase of tangible personal property. Taxpayer's refund claim for a manufacturing exemption is denied.

DISCUSSION

Taxpayer's claims for refund are partially granted to the extent described above.

CONCLUSION

Taxpayer's protest on Issue I regarding taxable status of transactions involving Software is sustained to the extent verified in a supplemental audit. Taxpayer's protest on Issue II is partially sustained and partially denied, as described above.

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